COPY

LMH Utilities Corporation

Cause No. 43431

Pre-Filed Testimony
and
Exhibits
of
Theodore J. Sommer
&
Judith I. Gemmecke

March 10, 2008

FILED
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INDIANA UTILITY
REGULATORY COMMISSION

LWG | LONDON WITTE GROUP

PETITIONER'S EXHIBIT NO. TJS

L.M.H. UTILITIES CORP.
CAUSE NUMBER 43431

Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Theodore J. Sommer, One American Square, Suite 2600, Indianapolis, Indiana, 46282.

Q2. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am a Partner with London Witte Group, LLC, Certified Public Accountants.

Q3. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN REGULATORY MATTERS.

A. I graduated from the University of Missouri in 1975 with a Bachelor of Arts Degree and in 1979 with a Master of Business Administration Degree. In February 1979, I accepted employment with the Missouri Public Service Commission as a Staff Accountant and worked there performing various duties entailing increasing levels of responsibility. In August of 1983, I accepted employment with the Indiana Office of Utility Consumer Counselor ("OUCC") as the Director of Utility Analysis. While with the Indiana Office of Utility Consumer Counselor, I served as Director of the Technical Staff and testified on behalf of the public in many telephone, water, electric and natural gas proceedings in front of the Indiana Utility

Regulatory Commission ("Commission"). In November of 1988, I accepted employment with London Witte & Company. I was a Partner with London Witte & Company, and am now a Partner with London Witte Group, LLC. I am the person in our firm responsible for our engagement with LMH Utilities, Inc.

Q4. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS?

A. Yes. I am a Certified Public Accountant, a member of the American Institute of Certified Public Accountants and the Indiana Society of Certified Public Accountants. I maintain memberships in the American Water Works Association, Indiana Regional Water Association, Indiana Sewer Association, Government Finance Officers Association and the Indiana Association of Cities and Towns. I am also a member of various charitable and not-for-profit boards unrelated to utility regulation.

Q5. MR. SOMMER, HAVE YOU EVER FILED OR PREPARED TESTIMONY BEFORE ANY REGULATORY BODIES?

A. Yes. I have filed and prepared testimony on numerous occasions in front of the Indiana, Missouri, Ohio, Illinois, Arizona and Federal Energy Regulatory Commissions.

Q6. ON WHOSE BEHALF ARE YOU APPEARING IN THIS CAUSE?

A. LMH Utilities Corp. (LMH).

Q7. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will present an overview of the issues that were discussed in the order in Petitioner's prior Cause Number 43022. I will also present an overview of the steps taken in the determination of rate base and the weighted cost of capital. Finally, I will provide the Commission with testimony that the rates currently being charged by LMH to its customers are insufficient and that an increase in rates is necessary for LMH to continue to provide safe and adequate service to its customers. The basis of our analysis is the test period for the twelve months ending September 31, 2007.

Q8. ARE THERE ANY SCHEDULES OR ATTACHMENTS INCLUDED WITH YOUR TESTIMONY?

A. Yes. I have attached the order in Fountaintown Gas Company, Inc. Cause Number 38517 issued March 8, 1989 in support of my testimony (Exhibit TJS-1). Schedules are included in Judith Gemmecke's testimony and are listed as Exhibit JIG-1.

Issues in Cause Number 43022

Q9. PLEASE OUTLINE THE ISSUES DISCUSSED IN THE ORDER DATED MARCH 22, 2007, WHICH RELATE TO THIS PROCEEDING.

A. The issues, as I understand them, are outlined below:

Accounting records – The utility needs to establish appropriate accounting records and thereafter keep records of all business transacted in a manner consistent with NARUC USoA standards.

Rate Base – Must include recognition of plant in service actually used and useful and reasonably necessary to the provision of utility service. That rate base must reasonably recognize the capital used to create the rate base.

Capital Structure – The utility should be cognizant of reasonable equity ratios.

System Development Charge – SDCs must be cost-based.

Collaboration with OUCC – The utility was encouraged to work collaboratively with the OUCC with respect to the above issues.

Q10. MR. SOMMER, WERE THERE OTHER ISSUES IN CAUSE NO. 43022 THAT DO NOT DIRECTLY RELATE TO THIS PROCEEDING?

A. Yes. There were various issues discussed in that order such as test year, CTAs, affiliated interest contracts, and others which I believe were relevant in that Cause, but do not directly relate to the issues here. Petitioner's request here is simply to set reasonable rates and charges. It is not proposing to amend its test year nor expand its CTA, nor borrow money, nor create affiliated transactions, all of which were issues initiated by Petitioner in that prior case.

Q11. HAS LMH TAKEN STEPS TO REMEDY THE IURC'S NOTED CONCERNS?

A. Yes. One of the main items that had come to light was the lack of reliable accounting books and records, primarily in the area of assets and contributions in aid of construction. After much review

of Petitioner's accounting records, IURC annual reports, and tax returns it became apparent that the fixed asset records could not be re-created from past records. Therefore, a study was conducted by Mr. Limcaco to determine an estimated original cost of the utility plant in service as well as the accumulated depreciation.

As to the capital structure, the short-term debt obligation originally taken out by the utility has been relieved by additional equity capital paid in by an existing shareholder who has provided those funds as equity to the utility.

The system development charge has been calculated based on actual cost.

Q12. IN THE COMMISSION'S ORDER IN CAUSE NUMBER 43022, THE COMMISSION STATED "...WE EXPECT THAT LMH WILL WORK COOPERATIVELY WITH THE OUCC TO ADDRESS THE CONCERNS THEY RAISED IN THIS PROCEEDING." HAS THIS HAPPENED?

A: Yes. I have met with the OUCC staff, exchanged material, and discussed the issues of that prior order on numerous occasions including discussing various approaches to how LMH might restate its books and records, rate base, eliminate affiliated transactions, and establish reasonable rates and charges.

Rates Overview

Q13. WHAT ARE THE PROPOSED RATES AS SET FORTH IN THIS TESTIMONY?

A: The rates proposed are set forth in Schedule 10 attached to Ms. Gemmecke's testimony. A customer using 5,000 gallons per month would pay $67.67 after the proposed rate is implemented. Of the increase requested, approximately 71% is due to the new treatment plant which was placed in service prior to the end of the test year (September 30, 2007). The remainder is due to correcting the recorded assets and contributed assets, net of efficiencies in operating expenses.

Q14. DO YOU BELIEVE THE RATES AND CHARGES PROPOSED BY PETITIONER ARE JUST AND REASONABLE?

A: Yes.

Rate Base

Q15. HAS PETITIONER DETERMINED A REASONABLE RATE BASE VALUE ON WHICH A REASONABLE RETURN IS TO BE CALCULATED?

A. Yes. Petitioner proposes a rate base of $2,546,660. This consists of Original Cost Utility Plant In Service of $7,580,869, less Accumulated Depreciation of $1,833,797, less Contributions in Aid of Construction net of Accumulated Amortization of CIAC of $3,339,337, assets held by affiliates used and useful to utility service of $83,250 plus working capital of $55,674. Rate base has

been calculated on schedule 4 included in Exhibit JIG-1.

Q16. WHAT ARE THE COMMON METHODOLOGIES FOR VALUING RATE BASE?

The most common rate base methodologies or measures of value are primarily the Original Cost Rate Base method and the Fair Value Rate Base Method, which were derived from the "fair value doctrine" as set forth by the courts and the Indiana Statute IC 8-1-2-6.

IC 8-1-2-6 states that the "commission shall value all property of every public utility actually used and useful for the convenience of the public at its fair value, giving such consideration as it deems appropriate in each case to all bases of valuation, which may be presented ...."

Q17. HOW DOES THE "ORIGINAL COST RATE BASE" DIFFER FROM THE "FAIR VALUE RATE BASE"?

A: The Original Cost Rate Base Method primarily values the Rate Base at its "First" Cost. It is the amount actually paid for installing the original plant and equipment plus additions, when first devoted to public service, less the accumulated accounting depreciation recorded in the books and records of the company. The original cost and accumulated accounting depreciation is sometimes referred to as the "net book value".

The Fair Value Rate Base Method is a determination of fair value based on original costs and accumulated book depreciation as well as replacement cost of the infrastructure, given the current depreciated condition. However, it has been the courts giving meaning to the statute, which uses "fair value," that has set forth the "Fair Value Doctrine." It is important to remember that, under the statutory standard of 'just and reasonable' it is the result reached not the method employed, which is controlling.

Q18. WERE THE RCNLD RESULTS USED IN THE CALCULATION OF RATES?

No. However, such a study was performed and is included with Mr. Limcaco's testimony in this Cause. The information derived from the RCNLD study was used to derive the estimated original cost of the infrastructure used to provide utility service.

Q19. HAS THIS COMMISSION EVER APPROVED A METHODOLOGY SUCH AS THE ONE PRESENTED HERE TO DETERMINE ORIGINAL COST OF UTILITY PLANT IN SERVICE?

A: Yes. Fountaintown Gas Company, Inc. Cause Number 38517 was such a case. Fountaintown Gas's accountant had died, asset records before a certain time were lost and subsequent recording of assets was unreliable. This same methodology was used in correcting its fixed asset records. The Commission ordered Fountaintown Gas to adjust its books according to the finding. A

copy of the order is attached to my testimony.

Q20. MR. SOMMER, DO YOU BELIEVE THE VALUE PLACED ON PETITIONER'S RATE BASE IS REASONABLE?

A. Yes, I do. I arrive at that conclusion for a variety of reasons. First, this rate base actually exists and is used and useful. Second, the actual original cost of the new expansion is very close to the estimated original cost of that portion of the plant in Mr. Limcaco's study. Third, this method of delivering value has been previously used without any ongoing problems. Fourth, if a value is not assigned, Petitioner's property will unfairly be taken without any compensation. Fifth, the application of this value in the rate setting process causes reasonable resulting rates.

Q21. MR. SOMMER, DO YOU BELIEVE THE COST OF CAPITAL USED IN PETITIONER'S CASE-IN-CHIEF IS REASONABLE?

A: Yes. Petitioner's weighted cost of capital is 9.75%. Without going to the added expense of hiring a cost of equity witness, a reasonable cost of equity was determined to be 10.25%. This was based on recently approved orders by the IURC for water and wastewater utilities. Using Indiana-American Water Company (10%), Chimneywood (11%), and Wymberly (11%) as a base for evaluating a reasonable cost of equity, it was determined that 10.25% would be reasonable.

Q22. AT THE BEGINNING OF YOUR TESTIMONY YOU REVIEWED THE ISSUES FROM THE PRIOR RATE CASE. YOU HAD CATEGORIZED SOME OF THOSE ISSUES AS NOT BEING DIRECTLY RELEVANT TO THIS CAUSE. DOES PETITIONER UNDERSTAND THE RELEVANCE OF THOSE ISSUES AS IT PERTAINS TO ITS CONDUCTING BUSINESS AS A REGULATED ENTITY?

A: Yes. I have discussed and reviewed the issues of Cause Number 43022 several times with Petitioner as has legal counsel. Petitioner understands the need for approval prior to issuing debt, the need for transparency in any dealings with affiliated entities, the need to keep their books and records in accordance with NARUC's System of Accounts, and the need to follow directives from this Commission. I believe the utility's management understands and recognizes that managing a regulated business requires a different approach than managing an unregulated business.

Q23. DO YOU BELIEVE LMH'S HIRING OF DIRECT PERSONNEL TO OPERATE AND MAINTAIN THE UTILITY IS A REASONABLE APPROACH TO LESSEN ITS DEPENDENCY ON AFFILIATED TRANSACTIONS?

A: Yes. LMH has grown to over 1,100 customers, which I believe warrants its own full-time employees to maintain and operate the facilities.

Q24. Does this conclude your testimony?

A: Yes.

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ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION OF FOUNTAINTOWN GAS COMPANY, INC., FOR AN ADJUSTMENT IN THE RATES CHARGED TO RESIDENTIAL AND COMMERCIAL CUSTOMERS	))))	CAUSE NO. 38517 APPROVED: MAR 0 8 1989

BY THE COMMISSION:
Lynn McDowell Pylitt, Assistant Chief Administrative Law Judge

On March 31, 1988, Fountaintown Gas Company, Inc., ("Petitioner") filed the above-captioned Petition with this Commission requesting an increase in its rates and charges. Pursuant to our Prehearing Conference Order and to notices duly published as required by law, a public hearing in this cause was held on December 12, 1988, at 9:30 a.m. in Room 907, State Office Building, Indianapolis, IN. At such hearing the Petitioner, the Office of the Utility Consumer Counselor ("Public") and the Staff of the Commission presented evidence regarding this cause. No other parties or members of the general public appeared. At the close of the hearing there were no pending motions or objections which had not been previously ruled upon. Based upon the applicable law, the evidence presented herein and being duly advised the Commission now finds:

1. Notice and Jurisdiction. Due, legal and timely notices of the hearing in this cause were given and published by the Commission and the Petitioner as required by law. Petitioner is a "public utility" within the meaning of the Public Service Commission Act and is subject to the jurisdiction of the Commission in the manner and to the extent provided by the laws of the State of Indiana. The commission has jurisdiction over Petitioner and the subject matter of this proceeding.

2. Petitioner's Characteristics. The Petitioner is an Indiana corporation with its principal office and place of business in Morristown, Shelby County, Indiana. Petitioner is engaged in the business of providing gas utility service to approximately 2,000 customers within the counties of Decatur, Hancock, Henry, Rush and Shelby Counties and including the towns of Finly, Fountaintown, Morristown, Gwynneville, Wilkinson, Shirley, Kennard, Sulphur Springs, St. Paul, Waldron, Marietta, Carthage and Freeport. Petitioner owns, operates manages and controls plant and property used to provide such service. Petitioner's current rates and charges were approved by this Commission on October 9, 1969, as modified to effect the changes in the cost of purchased pipeline gas, pursuant to orders entered by this Commission in various gas cost adjustment proceedings since that date.

3. Relief Requested. Petitioner seeks authority to increase its rates and charges so as to produce additional revenues of approximately $539,560. The proposed rates and charges are based upon a cost of service study and a proposal to separate Petitioner's current schedule into three separate classes of service. The additional revenues requested represent an approximate 20.6% increase to adjusted test year revenues, as those adjusted revenues were calculated by the Commission's Accounting Staff.

4. Test Year. The test year established in the Prehearing Conference Order issued in this cause and used in this proceeding is the 12 months ending December 31, 1987. The cutoff date for determining the value of Petitioner's utility plant in service was December 31, 1987. With adjustments for changes fixed, known and measurable, we find that the test year selected is sufficiently representative of the utility's normal operations to provide reliable data for ratemaking purposes.

5. Petitioner's Rate Base. The original cost of Petitioner's utility plant in service as of December 31, 1987 reflected in both Petitioner's Exhibit No. 3 and the report of the Commission's Accounting Division, Staff Report No. 3, was $3,261,816. Both exhibits also reflected adjusted accumulated depreciation of $1,080,629. The Petitioner proposed a $1,395,344 increase to its original cost of utility plant resulting in an adjusted utility plant in service figure of $4,657,160. As pointed out in Staff Report No. 2, the report of the Engineering Division of this Commission this amounts to a 41% increase in plant. In support of this adjustment, Petitioner's utility manager and president, Robert Wortman, presented the results of a plant appraisal study which was performed because Petitioner believed the figures recorded in its plant accounts did not reflect actual plant value. Mr. Wortman opined that in Petitioner's early years of operation plant accounts were not kept up-to-date nor accurately. Mr. Wortman testified that some plant expenditures were expensed rather than capitalized.

Petitioner's accounting witness, Duane Mercer, noted that pre-1978 detailed accounting records were lost with the death of Petitioner's pre-1978 accountant. He noted that Petitioner performed the plant appraisal study based on its belief that the reported book plant accounts do not properly reflect the true value of the plant in service. As noted by Petitioner's witness, Donald E. Gimbel, the first step in the study was the development of present day costs for all the distribution plant equipment. These figures are contained in Petitioner's Exhibit No. 2. Mr. Gimbel took such costs and adjusted them to the in-service date of the equipment by the use of the Handy-Whitman index. In commenting on Petitioner's analysis, the Commission's Engineering Division noted as follows:

> Petitioner has done a very thorough, detailed analysis of its system and itemized each component at current day cost.

These current costs were then adjusted to actual cost using the Handy-Whitman index. The Petitioner took a conservative approach in its plant appraisal. For example, lower priced plastic main was used for all the commercial services, in many instances the conversion indexes were lower than they should have been, all small general services were sized at 175 cubic feet even though some are larger and three river crossings were not included in the study. The Engineering Staff finds this approach reasonable for determining original cost of plant. The current costs utilized by the utility were comparable to costs currently reported by other Indiana gas utilities. Staff recommends that the Petitioner not be allowed to continually perform these plant evaluations with each rate case. The plant accounts should be adjusted accordingly after an Order is issued in this Cause and the utility should strive to maintain accurate records from this point on.

The Public's witness, Doug Harrison, recommended that Petitioner's proposed adjustment to its original cost rate base be disallowed. Mr. Harrison presented several capitalization ratios for Petitioner and other Indiana Gas distribution companies for the purpose of determining the reasonableness of Petitioner's actual booked gross utility plant balance relative to other gas companies. He opined that each analysis indicates that Petitioner's booked utility balance is in line with the rest of the industry and thus reasonable. While these analyses indicate that Petitioner has a higher capitalization per customer than any of the gas utilities in the comparison group, on rebuttal, Petitioner's witness Mercer questioned the validity of such comparison. He pointed out that factors such as customer concentration, geographical areas served, and customer mix make a comparison of companies impossible.

Mr. Harrison also opined that it is inappropriate to adjust the original cost of utility plant based upon the application of a valuation study. He testified that a plant valuation study is nothing more than an estimation process based upon a series of hypothetical assumptions and generic factors and cannot possibly duplicate the actual operating conditions in existence for an individual company at the time historical construction activities took place. He offered several reasons why the financial books and records of an individual company are the most accurate reflection of construction activities and the financial reality at the time such activities took place.

In support of the Public's position that a hypothetical evaluation study cannot replicate book values, the Public presented its Exhibit No. 3, a schedule comparing the booked cost of 1985-1987 utility plant additions to the hypothetical costs for those additions derived through the valuation study. The Exhibit indicates that the valuation study produced a plant addition value for the three years that is approximately 25% greater than the actual book value. On rebuttal however, Mr.

Gimbel indicated that such results could well be expected from an analysis of this brief time period and opined that when taken as a whole over the entire study period, the study methodology and results are quite accurate. He also pointed out that the exhibit included meters which were inactive rather than in-service and speculated that this may well have contributed to the difference.

While presenting no direct evidence regarding the use or misuse of the Handy-Whitman index, through cross-examination of certain of Petitioner's witnesses, the Public brought into question its use for this particular purpose. While this Commission is well aware that the Handy-Whitman index is typically used to proceed from an historical original cost figure to a present fair value figure through use of certain trending factors, its "backward" use to determine original cost figures when the reproduction cost new of an item is known has been accepted and approved by this Commission in previous causes. Mr. Gimbel emphatically supported its use for such purpose and the Public presented no direct evidence to convince us that this "backward" use is erroneous.

We are persuaded by the evidence of record that Petitioner's utility plant is undervalued on its books. We are also persuaded that Petitioner's plant appraisal study is thorough and sound and that its results are a reasonable reflection of the current value of Petitioner's plant. We also believe that the methodology used to determine original cost based on the results of the study is valid. Thus, we see no reason why Petitioner should not be allowed to make the proposed adjustment to its original cost rate base on its books.

While we have decided to accept Petitioner's plant valuation adjustment for purposes of determining Petitioner's original cost rate base, for purposes of our evaluating Petitioner's plant, such decision doesn't really matter. For, as is well known by all, Indiana Code 8-1-2-6 requires the Commission to value all property of every public utility actually used and useful for the convenience of the public at its "fair value". While typically the Commission arrives at a fair value figure by looking at the reproduction cost new or present value of a utility's original cost rate base, this is not immemorial. As a matter of fact, the Indiana Court of Appeals in its decision in Indianapolis Water Company v. Public Service Commission, 484 N.E.2d 635(1985) set forth four directives that the Commission should consider in determining "fair value". These directives are as follows:

a. That it is upon the statutory "fair value" of its used and useful property that a utility should be allowed to earn a return.

b. That "fair value" is not an either/or situation as to original cost or reproduction cost new, but "fair value" is a conclusion or final figure, drawn from all the various values or factors to be weighed in accordance with the statute by the Commission.

c. That in its determination of "fair value" the Commission may not ignore the commonly known and recognized fact of inflation.

d. That while original cost is one of the factors which the Commission should consider in arriving at a "fair value" figure, it is not necessarily in and of itself, an accurate reflection of the "fair value" of the company's property.

Petitioner's accountant testified that the "fair value" less depreciation of Petitioner's gas property used and useful for the convenience of the Public was no more than $5,033,165 and no less than $3,632,090. The plant appraisal study performed by Mr. Wortman concluded that the "present day" value of Petitioner's property used in furnishing utility service is $6,481,258. Under cross-examination, Mr. Gimbel indicated that "present day cost" was the equivalent of reproduction cost new. As noted above, the Court has cautioned that "fair value" cannot be polarized as to original cost or reproduction cost new but must be drawn from all the various values or factors considered by the Commission. While rejecting the Petitioner's adjustment to original cost rate base, the Public presented no evidence as to a figure which properly reflects the "fair value" of Petitioner's property. As discussed heretofor, the Engineering Staff of the Commission opined that Petitioner's appraisal was conservative, reasonable and the end result a proper reflection of the value of utility plant being used to provide service.

Based on all of the above and taking into consideration all of the evidence of record regarding Petitioner's plant and the law regarding this matter, we find that the fair value of Petitioner's plant in service, on which it should be allowed to earn a return, is $5,033,165.

6. Rate of Return. Among the items appropriately considered by the Commission in determining a utility's authorized return on the fair value of its utility plant is that utility's weighted cost of capital. In determining Petitioner's weighted cost of capital, the Commission must first consider the appropriate capital structure. The capital structure set forth in Petitioner's Exhibit No. 3 is different from that set forth in Staff Report No. 3, the Report of the Commission's Accounting Division. The difference is in the amount attributed to the common equity portion of Petitioner's capital structure. The Petitioner shows a common equity figure of $1,515,834 while the Commission's Accounting Staff shows such figure to be $2,544,251. As explained by the sponsor of the Staff's Report, Domenick Jervis, the higher figure reported by Staff is due to an adjustment to retained earnings made by the Staff to reflect the upward adjustment to Petitioner's original cost rate base. Since we have declined above to make such adjustment to Petitioner's original cost rate base, we find that in calculating Petitioner's weighted cost of capital, we should use the capital structure set forth in Petitioner's Exhibit No. 3.

The only matter in dispute in determining Petitioner's weighted cost of capital is the appropriate return on common equity. Petitioner's Accounting witness testified that a cost of equity ranging from 12.25% to 13.25% is appropriate in this Cause and to be used a figure of 12.75% in determining Petitioner's weighted cost of capital. The Economics and Finance Division of the Commission recommended in Staff Report No. 1 that the Commission use a cost of equity capital of 12.75% for Petitioner. This recommendation was based on the results of discounted cash flow analyses on two different groups of natural gas distribution companies which showed that a cost of equity capital ranging from 12.5% to 13.0% is appropriate for Petitioner. The Public's witness, Doug Harrison opined that 12.25% represents a reasonable estimate of Petitioner's common equity cost. Mr. Harrison's opinion was based on an analysis using the discounted cash flow technique and another analysis using the capital asset pricing model. Mr. Harrison's DCF analysis produced a cost of common equity ranging from 10.45% to 13.83% with the average for the 31 comparison companies being 12.14%. Mr. Harrison opined that Petitioner's financial risk is less than the average for the comparison companies because of its sales mix and operating margin. His CAPM analysis produced a cost of equity range of 11.41% to 13.32% with an average of 12.37%. He noted that his 12.25% recommendation represents an average of the DCF and CAPM result. Petitioner did not dispute the results of the analyses performed by Mr. Bolinger or Mr. Harrison.

Based on the evidence of record we find that a return on common equity capital of 12.5% takes into account the divergent opinions discussed above and we are confident that such a return will reasonably compensate Petitioner's investors for risks inherent in its gas business without penalizing ratepayers. Thus, we find such return just and appropriate.

In order to comply with 51 F.R. 18775-18778 and consistent with our previous orders, we must determine Petitioner's overall weighted cost of capital by assigning a cost to Petitioner's investment tax credit which is no less than the overall weighted cost of capital. As we noted in our Order in Cause No. 37837, such cost of capital is determined by assuming "that such capital would be provided by common shareholders, preferred shareholders and long-term creditors in the same proportions and at the same rates of return as the capital actually provided to the tax payer by such shareholders and creditors." We have determined that the cost which should be assigned to this investment tax credit is 12.01% as calculated below:

Type	Amount	% of Total	Cost	Weighted Cost
Common equity	$1,515,834	86.98%	12.5%	10.87%
Debt	226,854	13.02	8.75	1.14
Total	$1,742,688	100.00%		12.01%

Based on all of the above we find Petitioner's weighted cost of capital to be considered by the Commission in determining the reasonable rate of return to Petitioner for purposes of this proceeding is 9.33% as calculated below:

Type of capital	Amount	% of Total	Cost	Weighted Cost
Common equity	$1,515,834	60.62%	12.5%	7.58%
Note payable	226,854	9.07	8.75	.79
Customer deposits	41,557	1.66	6.0	.10
Post-1970 ITC	178,714	7.15	12.01	.86
Deferred taxes	537,594	21.5	0.0	0.0
Total	$2,500,553	100.00%		9.33%

As we have noted in previous Causes, the application of a utility's weighted cost of capital to its original cost rate base is one consideration in determining that utility's fair return. However, it should not be our sole consideration. Nor should we apply the weighted cost of capital to the fair value of a utility's property for, as we have noted in previous orders, to do so would double account for inflation. A reasonable approach to the determination of a fair return for application to the fair value of Petitioner's property is to reduce the weighted cost of capital to remove the inflationary considerations. In addition, the Commission must balance the interests of the Petitioner's share holders and its ratepayers. A fair return must be fixed so that the resulting rates neither unduly burden the ratepayer nor confiscate the investors' property.

Based upon the above factors, the foregoing evidentiary findings and determinations and taking into account the Petitioner's capital structure, the evidence as to its overall cost of capital, its earnings experience, present economic conditions including cost of capital, and various other financial factors affecting this Petitioner and, considering our duty to balance the interests of Petitioner's shareholders and ratepayers, the Commission finds that Petitioner should be authorized to earn a 6.75% return on the fair value of its used and useful property. Applying this percent return to Petitioner's fair value rate base, less depreciation, provides for a net operating income of $339,738. Based on the evidence and considering all relevant factors, we find that this net operating income equates to and provides the Petitioner with a fair and reasonable return on the fair value of its property dedicated to the service of the public.

7. Petitioner's Operating Results at Present Rates. Both Petitioner's evidence and the evidence of the Commission's Accounting Staff indicate that for the 12 months ended December 31, 1987, Petitioner's actual operating results were as follows:

Total Operating Revenue	$2,832,213
Operating Expenses and Taxes	
Operation and maintenance expense	2,506,512
Depreciation expense	110,907
Tax expense	107,895
Total Operating Expenses	$2,725,314
Net Operating Income	$ 106,899

Petitioner, the Public and the Commission Staff proposed a number of adjustments to the test year results. Many of the adjustments proposed by Petitioner's accountant and Mr. Domenick Jervis of the Commission's Accounting Staff were very similar. At the hearing in this Cause, Petitioner's accountant indicated that Petitioner was willing to accept the adjustments and figures for such contained in Staff Report No. 3 subject to five exceptions, those being the adjustments proposed by the Staff for rent expense, additional accounting expense, director fees, legal expense and property taxes. These disputed adjustments are discussed below:

(a) Rent Expense. Petitioner's accounting witness made an upward adjustment of $4,500 to reflect an increase in the cost of rent from the test year figure of $13,500 to the pro forma figure of $18,000. The test year figure was the result of Petitioner paying $750 per month for 6 months and $1,500 per month for the other 6 months following the implementation of an increase by the utility's landlord who is also its president and its majority stockholder. Petitioner's accountant testified that the increase in rent was imposed after a survey was taken which demonstrated that the $750 rental figure was lower than rent charged for comparable space and property in the Morristown area and which further showed that a reasonable charge based upon rental figures for comparable space in the Morristown area was $1,500. The Staff expressed its concern that the increase was a related party transaction and that there was no evidence to substantiate Petitioner's opinion that the amount is reasonable. We, too, in light of the circumstances are unconvinced as to the reasonableness of the 100% increase in rental payments to Petitioner's president and majority stockholder. We find that the Petitioner's upward adjustment of $4,500 should be rejected.

(b) Additional Accounting Expense. The Petitioner made an upward adjustment of $6,000 to cover the expense for annual accounting services for the preparation of reviewed financial statements. The Commission's Accounting Staff recommended that this adjustment be disallowed because (i) there was no evidence to indicate that Petitioner's financial statements are being reviewed and (ii) the additional accounting services do not provide any additional benefit to

Petitioner's ratepayers. In rebuttal, Mr. Mercer testified that the reviewed financial statements were prepared in February of 1988 and thus fall within the 12 month period following the end of the test year. He also opined that the preparation of such statements is necessary in today's business world and that the failure to provide such statements to lending institutions could have dire consequences. We believe that Petitioner's ratepayers have an interest in Petitioner's not only keeping proper accounting records but also complying with reporting requirements of lending institutions and others. We are also convinced by Mr. Mercer's testimony that the service is being performed. While we are a bit skeptical as to whether or not the $6,000 charge is reasonable in amount, neither the Public nor the Commission Staff questioned the reasonableness of the actual amount. We find that the adjustment should be accepted.

(c) Director Fees. The Petitioner made an upward adjustment of $5,400 to reflect the payment of directors' fees. The amount reflects the payment of $150 to each of 3 directors per meeting for 12 meetings per year. Mr. Jervis pointed out that the directors include the utility's president who owns 90% of its stock, his wife, who owns no stock in her own name but earns $15,000 annual salary as office manager and the utility's attorney, who owns 10% of the stock. Mr. Jervis opined that monthly board meetings are probably not necessary for a utility the size of Petitioner and that even if such regular monthly board meetings are justified, the people who gain by collecting directors' fees are the same people who profit from the utility. Mr. Jervis expressed his opinion that if payments to directors are made then such payments should be below the line and not charged to Petitioner's ratepayers.

When questioned regarding the directors' meetings, Petitioner's witness stated that they are held monthly and usually last about two hours. Thus, the evidence of record indicates that the directors' meetings are held and the directors attend them. While it may well seem inequitable that the directors who are going to be paid for participating in such meetings are the two stockholders of the company and the majority stockholder's wife, we do not believe that we can treat this investor-owned utility any differently than other investor-owned utilities are treated in this regard simply because it is a closely held corporation. Neither the Public nor the Accounting Staff of the Commission presented evidence to indicate that the amounts to be paid the directors are unreasonable. Were there such evidence we might be inclined to reduce the amount of the adjustment. However, based on the evidence of record and the law, we find that the adjustment should be accepted.

(d) Legal Expense. Petitioner's test year legal expense totaled $18,123.50. Petitioner made no adjustment to this figure. The Accounting Staff of the Commission on the other hand made a downward adjustment of $15,123 based on its conclusion that pro forma legal expense of $18,123 is excessive and unreasonable and the fact that Petitioner had no itemized accounts regarding legal services rendered by its attorney. Mr. Jervis opined that a reasonable pro forma expense for legal services is $3,000. He arrived at such figure by estimating the cost of legal representation for Petitioner's quarterly GCA filings. In rebuttal, Petitioner's witness, Duane Mercer, noted that Petitioner required legal representation in situations other than gas cost adjustment filings, including claims, collections, law suits and contract negotiations. Under cross-examination Mr. Mercer admitted that some of the test year legal expenditures were due to negotiations with Petitioner's natural gas supplier and to negotiations regarding the purchase of Fountaintown Gas by Indiana Gas Company. While these two particular expenses may well be non-recurring we believe that most utilities including Petitioner have numerous legal expenses in addition to those associated with GCA filings or for that matter regulatory matters. Thus, we find that our Accounting Staff's proposed adjustment to the test year figure for legal expenses should be rejected. We would caution Petitioner however to keep detailed records of legal services rendered and individual payments for such in the future.

(e) Property Taxes. Petitioner calculated its pro forma property taxes based upon the presumption that its plant valuation adjustment would be accepted and the increased valuation would result in additional property tax. The Commission's Accounting Staff did not consider the increased valuation in calculating its figure. Petitioner's witness, Mercer, indicated that the Indiana State Board of Tax Commissioners had already made a reassessment of Petitioner's plant and property and that despite this Commission's decision regarding the plant valuation adjustment, Petitioner would be paying the higher property tax figure. Since we have approved Petitioner's plant valuation adjustment, we believe that we should approve adjustments to Petitioner's property tax expense which reflect the higher plant figure. We also believe that we should take administrative notice of the records of the Indiana State Board of Tax Commissioners which indicate that the actual amount of taxes assessed is $61,783. Thus, we find that the pro forma, adjusted expense for taxes other than income is $75,427 and that such figure should be used in calculating Petitioner's total operating expenses.

(f) Depreciation Expense. Both Mr. Mercer and Mr. Jervis calculated Petitioner's depreciation expense including the proposed plant valuation adjustment. Public's witness,

Harrison, contended that if the Commission accepted Petitioner's plant valuation adjustment, we should at the very least eliminate the depreciation expense associated with the adjustment. Mr. Harrison pointed out that Petitioner's annual reports for the years 1969 through 1987 demonstrate that it fully recovered its operating expenses in each year and to allow recovery for any of those same expenditures now, including depreciation, will result in double recovery. Under cross-examination, Mr. Mercer admitted that he could not state whether or not these expenses had already been recovered and Petitioner presented no other evidence to rebut Mr. Harrison's position. Based on such, we find that the adjustments to test year depreciation expense made by Mr. Mercer and Mr. Jervis based upon the plant valuation adjustment should be rejected. We further find that using the same calculations contained in Staff Report No. 3, but eliminating the plant valuation adjustment, results in pro forma depreciation expense totaling $118,857 and subtracting from such figure test year depreciation expense of $110,907 a necessary adjustment of only $7,950.

Based upon the evidence of record and the determinations made above, we find that Petitioner's adjusted operating results under present rates are as follows:

Total Operating Revenues	$2,618,546
Operating Expenses and Taxes	
Operation and maintenance	2,310,207
Depreciation	118,857
Taxes other than income	75,427
Income taxes	56,012
Total Operating Expenses and Taxes	$2,560,503
Net Operating Income	$ 58,043

As can be seen above, Petitioner's net operating income is $58,043. This represents a rate of return of 1.15% on the fair value of Petitioner's gas utility property as determined in Finding No. 5. This is less than the rate of return determined to be fair and reasonable. Accordingly, we find that Petitioner's present rates for gas utility service are unjust and unreasonable in that they are insufficient to provide a fair return on the fair value of Petitioner's gas utility property used and useful for the convenience of the public.

8. Revenue Requirement. Based on findings 5 and 6 herein, Petitioner is entitled to net operating income in the amount of $339,738 which is a fair return upon the fair value of Petitioner's property used and useful and reasonably necessary for the convenience of the Public. Accordingly, the Commission finds that Petitioner's rates should be increased to produce additional operating revenue of $452,961 and total operating

revenue in the amount of $3,071,507. The increase in revenues will give rise to increased tax expense and, as a result, expenses totalling $2,731,769 resulting in the above net operating income. We note that allowing Petitioner to increase its rates to produce $452,961 of additional annual revenues represents an approximately 17.62% increase in revenues over adjusted test year revenues.

The Commission further finds that Petitioner's proposed increase in revenues of $539,560 is more than the additional revenues herein found to be necessary to provide Petitioner with a fair return on the fair value of its property. Petitioner will, therefor, be ordered to file with this Commission a new schedule of rates and charges which will provide the operating revenues herein found to be just and reasonable.

9. **Rate Structure.** Petitioner has submitted new tariff sheets with proposed rates which were developed based upon a cost of service study performed by Mr. Donald Gimbel. In order to be able to more accurately recover costs associated with particular classes of customers, Petitioner has separated its existing tariff sheet into other individual tariff sheets. The original sheet which provided for gas purchased under general and industrial rates has been separated into three individual tariff classes including residential services, commercial service, and industrial service. Additionally, the two existing transportation tariffs have been condensed into one tariff schedule for transportation service. The Engineering Staff of the Commission recommended that the proposed new tariff sheets, with the exception of the proposed rates, be approved by the Commission. The Staff also recommended that since Petitioner is billed by its supplier in units of dekatherms that the usage blocks and rates shown on the tariff sheets for each class of service should be indicated in dekatherms rather than cubic feet and that Petitioner should start billing in units of dekatherms at the time its new rates become effective. Petitioner did not dispute this recommendation and we find that it should be followed.

The Petitioner proposed that the revenue increase be allocated pursuant to the results of its cost-of-service study. The Commission's Engineering Division reviewed the study and prepared its own cost-of-service study using certain different methods and, in some instances, relying on somewhat different data. Based on such, the two studies produced different rate of return figures for the classes of customers. Neither Petitioner nor the Public disputed the methods used by the Commission Staff in its cost-of-service study or the results of such study. We believe the Staff's study is sound and reasonable and find that it should be used in allocating the revenue increase authorized herein.

Under both Petitioner's and the Commission Staff's cost-of-service studies, both the residential and commerical classes are

currently being subsidized by the industrial and transportation classes. The Petitioner proposed that revenues be allocated among classes so as to reduce the subsidy/excess revenues produced by each rate class by an equal 10%. As pointed out in Staff Report No. 2, although other levels of reduction are possible, the Petitioner felt that a reduction in subsidy/excess revenue of greater than 10% would yield an excessive rate increase to the residential class. The Engineering Staff noted that under its cost-of-service study, a 20% reduction in subsidy/excess revenues produces a percentage increase for the residential class which is approximately equal to the percentage increase proposed for this class by the Petitioner at a 10% reduction in subsidy/excess revenues. The Engineering Staff recommended that the maximum subsidy/excess reduction be 20% for all classes because a reduction greater than 20% would result in a drastic rate increase for the residential rate class.

Based on the revenues proposed by Petitioner and using the staff's cost-of-service study a 10% reduction in subsidy/excess would result in a 36.03% increase for residential customers and a 20% reduction in subsidy/excess would result in a 38.84% increase for residential customers. Maintaining current subsidy/excess ratios would result in a 33.22% increase. These percentages will of course be lower since we have found above that Petitioner is entitled to a smaller amount of revenues than those proposed and due to pro forma revenue and expense adjustments. The principle that revenue responsibility assignment to individual rate classes should reflect the cost of serving those individual rate classes as closely as may be reasonably practical is well established in this state. On the other hand, this Commission has on numerous occasions expressed its belief that movement toward cost-of-service should be gradual so as to avoid rate shock to the residential customers. Based on such principles and the record before us we find that the allocation of the revenue increase approved herein should incorporate a reduction in subsidy/excess revenues of 10% based on the Engineering Staff's cost-of-service study.

10. **Other Engineering Recommendations**. The Engineering Staff of the Commission in Staff Report No.2 made numerous recommendations. The recommendations which have not been dealt with in other sections of this Order were as follows:

(a) That Petitioner comply with 170 IAC 5-1-4(B),9,15(D), 18(A) and 28 and that the Engineering Staff be allowed to perform a follow-up review of Petitioner's compliance with 170 IAC 5-1 within one year of the issuance of an Order in this Cause.

(b) That Petitioner utilize its rebuilt meters.

(c) That Petitioner's proposed service charges be included in its new tariff sheets.

The Petitioner expressed no opposition to these recommendations, we find them to be reasonable and further find that Petitioner should be ordered to comply with them.

11. Base Cost of Gas. The evidence established that the new figures for Petitioner's base cost of gas should be $4.9288 per Dth for the residential class, $4.8547 per Dth for the commercial class, and $4.5601 per Dth for the industrial class. Based on such, we find that we should establish these base costs of gas in our Ordering paragraphs herein.

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. Petitioner shall be and is hereby authorized to increase its rates and charges for gas utility service in accordance with the findings herein so as to produce approximately 17.62% or $452,961 of additional operating revenue and total annual operating revenue in the amount of $3,071,507. Petitioner is hereby authorized to file with this Commission a new schedule of rates and charges which will properly reflect, establish and provide the additional operating revenue found to be just and reasonable. The new rates and charges shall be in accordance with our Finding No. 9 regarding class revenue responsibility.

2. Petitioner shall file with the Engineering Division of the Commission a new schedule of rates and charges consistent with the findings herein. Said tariffs, when filed and approved by the Engineering Division, shall cancel the present and prior rates and charges concurrently when the new rates and charges are placed in effect by Petitioner. The new rates and charges shall not become effective until approval thereof by the Engineering Division of this Commission. Such rates and charges shall be accompanied by a simultaneous refiling of Appendix A, the gas cost adjustment and Appendix B, base cost of gas, as of the date of approval of such new rates and charges, modified to reflect the amount of purchased gas cost which is included in Petitioner's basic rates. The base costs of gas shall be reflected as set forth in Finding No. 11 of this Order.

3. Petitioner shall comply with the recommendations of the Engineering Division of this Commission contained in Finding Nos. 9 and 10 of this Order.

4. This Order shall be effective on and after the date of its approval.

DUVALL, BAILEY ZAGROVICH AND O'LESSKER CONCUR; CORBAN CONCURS WITH OPINION

APPROVED: MAR 08 1989

I hereby certify that the above is a true and correct copy of the Order as approved.

Secretary

3LC

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE PETITION OF FOUNTAINTOWN GAS COMPANY, INC., FOR AN ADJUSTMENT IN THE RATES CHARGED TO RESIDENTIAL AND COMMERCIAL CUSTOMERS	))))	CAUSE NO. 38517

CONCURRING OPINION OF COMMISSIONER CORBAN

The Order in this Cause adequately describes the basis supporting an increase in the rates and charges of the Petitioner. I concur in these findings but note the substantial overall increase of approximately 17.62% and the increase in residential rates which could be viewed as "rate shock." The Order appropriately states that simply maintaining the current subsidy/excess ratios would still require a major increase in rates for residential customers.

The apparent cause of this dramatic change is the extended period since Petitioner's last rate case. The effective change since the last rate case is less than 1% per year in overall rates and less than 2% per year for residential customers. That does not appear excessive; however, more frequent adjustment of Petitioner's rates would have allowed reduction of subsidies without rate shock. Surely this would have been more equitable.

The Legislature has directed the Commission to review the rates of larger utilities at least every four years to determine whether rates are excessive. Such a review would not have applied in this case because Petitioner is a small utility and the previous rates do not appear excessive. Without review, however, we do not know whether the rates have been appropriate for the entire 19 year period. Unfortunately, Orders such as this one give customers the false impression that there has been a dramatic change in the cost of gas utility service.

I concur in the result but continue to be concerned about the false signals being given by such Orders.

FLC/dmb

PETITIONER'S EXHIBIT NO. JIG

L.M.H. UTILITIES CORP.
CAUSE NUMBER 43431

Q1: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Judith I. Gemmecke and my business address is One American Square, Suite 2600, Indianapolis, Indiana, 46282.

Q2: BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A: I am employed by London Witte Group, LLC, Certified Public Accountants, as a manager.

Q3: PLEASE DESCRIBE YOUR CREDENTIALS.

A: I graduated from Indiana University in Bloomington, Indiana in May 1983, with a Bachelor of Science degree majoring in public administration with a concentration in public finance. I obtained a certificate in accounting from Indiana University, South Bend in January 1990, at which time I accepted a seasonal position with Coopers & Lybrand as part of its auditing staff. From September 1990 until March 1999, I held the position of field auditor for the Indiana Department of Revenue. In March 1999, I accepted a position as a staff accountant (Utility Analyst) with the OUCC. I have been with London Witte Group, LLC since August 2007.

Q4: DO YOU HOLD ANY PROFESSIONAL LICENSES?

A: I am licensed in the State of Indiana as a Certified Public Accountant. I am also a Certified Grant Administrator.

Q5. MS. GEMMECKE, HAVE YOU EVER FILED OR PREPARED TESTIMONY BEFORE THIS REGULATORY BODY?

A. Yes. I have filed and prepared testimony on numerous occasions in front of the Indiana Utility Regulatory Commission.

Q6. ON WHOSE BEHALF ARE YOU APPEARING IN THIS CAUSE?

A. LMH Utilities, Inc. (LMH).

Q7. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will address certain issues pertaining to Petitioner's accounting books and records that were discussed in Petitioner's prior Cause Number 43022. Specifically, I will discuss rate base items of assets, depreciation, contributions in aid of construction (CIAC) and amortization of CIAC. I will also provide testimony pertaining to adjustments that need to be made to the accounting books to record assets and depreciation that had not been previously recorded on LMH's books. I will also discuss the proposed non-recurring charges and the proposed wholesale rate. Finally, I will provide the Commission with testimony and evidence that demonstrates the rates currently being charged by LMH to its customers are insufficient and that an increase in rates is

necessary for LMH to continue to provide safe and adequate service to its customers. The basis of the analysis is the test period for the twelve months ending September 31, 2007.

Q8: ARE THERE ANY SCHEDULES OR ATTACHMENTS INCLUDED WITH YOUR TESTIMONY?

A. Yes. The following schedules are included and attached to my testimony as Exhibit JIG-1:

Schedule 1 – Revenue requirements and Gross Revenue Conversion Factor

Schedule 2 - Balance Sheet as of 9/30/07 with proposed adjustments.

Schedule 3 - Income Statement for the twelve months ending 9/30/07

Schedule 4 - Calculation of Rate Base and Working Capital

Schedule 5 - Calculation of Weighted Cost of Capital and Interest Synchronization.

Schedule 6 - Pro Forma Net Operating Income Statement

Schedule 7 - Revenue Adjustments

Schedule 8 - Expense Adjustments

Schedule 9 - Calculation of Non-Recurring Charges & Wholesale Rate

Schedule 10 - Current and Proposed Rates and Charges

Issues in Cause Number 43022

Q9. ARE YOU FAMILIAR WITH THE ISSUES DISCUSSED IN THE ORDER DATED MARCH 22, 2007?

A. Yes, very much so.

Q10. HAS LMH TAKEN STEPS TO REMEDY THE IURC'S AND THE OUCC'S CONCERNS?

Yes. Mr. Sommer has also testified that the concerns from Cause No. 43022 have been addressed by the utility. It is our goal to fully address the concerns and the remedies in Petitioner's case-in-chief.

Q11: IN THE COMMISSION'S ORDER IN CAUSE NUMBER 43022, THE COMMISSION STATED "...WE EXPECT THAT LMH WILL WORK COOPERATIVELY WITH THE OUCC TO ADDRESS THE CONCERNS THEY RAISED IN THIS PROCEEDING." HAS THIS HAPPENED?

A: Yes. Representatives of the Petitioner have met with members of the OUCC on several occasions to discuss the proposed methodology in determining utility plant in service and the impact on the accounting books as well as getting their suggestions and input. I have strived to address those suggestions through the analysis process and hope to relay the process and my conclusions through this testimony.

Rates Overview

Q12: WHAT ARE THE PROPOSED RATES AS SET FORTH IN THIS TESTIMONY AND THE ATTACHED SCHEDULES?

A: The rates proposed are set forth in Schedule 10 attached to this testimony. While the proposed increase is large, keep in mind that the utility has not increased its rates for ten years. Further, its existing rates are based on a June 1997 test year. In addition, Petitioner has recently expanded its treatment plant which cost Petitioner almost $1.4 million.

Utility Plant in Service

Q.13: HAVE YOU PROVIDED AN AMOUNT FOR UTILITY PLANT IN SERVICE ("UPIS")?

A: Yes. Utility plant in service as of 9/30/07 has been determined to be $7,580,869.

Q14: EXPLAIN HOW THE UPIS WAS DETERMINED.

A: The details of the actual calculation and the engineering aspects of the study conducted to arrive at the amount will be discussed by Chris Limcaco. The method used, given the problems with the accounting books as stated previously, was to have a Replacement Cost New ("RCN") study performed and then use the Handy-Whitman index to determine the original cost when installed. Then, the depreciation factor derived from the Replacement Cost New Less Depreciation (RCNLD) study was used to determine the

amount of accumulated depreciation based on the estimated original cost of the assets. For example, Mr. Limcaco's Exhibit CAL-1 represents the RCNLD study and shows the replacement cost lift station #1 built in 1989. He then states that it has a remaining life of .28 (28% of its total life is remaining). That means it is .72 (72%) depreciated. Exhibit CAL-2, Mr. Limcaco has calculated the original cost by using the Handy-Whitman index to calculate back to what it would have cost in 1989 (original cost). Next the accumulated depreciation is determined (100% - 28% = 72%). The result being the net book cost of the lift station:

EXAMPLE	A	B	C	D	E	
	2007 cost	1989 cost	remaining life	% depreciated (100%-28%)	Accum Depr (B x D)	Net Book Cost (B - E)
Lift Station	$25,000	$13,275	28%	72%	$9,558	$3,717

Mr. Limcaco's analysis did not include transportation equipment, office equipment and other machinery and equipment. These asset categories were added to come to a total utility plant in service amount.

Q15: WERE ANY TESTS PERFORMED TO DETERMINE IF THE OVERALL RESULTS OF THE STUDY WERE REASONABLE?

A: Yes. In addition to the reasonableness tests performed by Mr. Limcaco, I have compared the "original cost" for the new treatment plant of the study with that of the job ledger. The job ledger shows a total of $1,362,827 for the new treatment plant. Mr. Limcaco's

study shows an estimate of original cost of $1,395,237 for the new treatment plant. The difference between the two amounts reflects only a 2.323% difference.

Q16: WHAT REASONS COULD THERE BE FOR THE SLIGHT DISCREPANCY BETWEEN THE TWO AMOUNTS?

A: One explanation could be that the labor used by LMH in constructing its treatment plant cost less than that used by other construction companies for the same type of facilities. Additionally, LMH has been in a tight cash flow situation during the construction and has been frugal in its spending.

Q17: HAS SUCH A METHODOLOGY TO DETERMINE ORIGINAL COST OF UTILITY PLANT IN SERVICE EVER BEEN APPROVED BY THE IURC?

A: Yes. Fountaintown Gas Company, Inc. Cause Number 38517 was such a case. Fountaintown Gas's accountant had died, asset records before a certain time were lost and subsequent recording of assets was unreliable. This same methodology was used in correcting its fixed asset records. A copy of the order is attached to Mr. Sommer's testimony.

Q18: DID YOU EXPLORE OTHER METHODS TO DETERMINE THE ORIGINAL COST OF THE UTILITY PLANT?

A: Yes. First we looked at the federal income tax returns and Schedule L in particular. Copies of all tax returns from 1990 through 2005 were obtained from the utility. We were hopeful we

could use the actual figures from the tax returns for the fixed assets. However these figures did not contain any assets that were contributed by developers (CIAC) – it only included assets specifically paid for by the utility. Additionally, LMH had changed accounting firms in late 1995 and from 1996 through 2005 the accounting firm did not properly account for assets/expenses. Since the taxpayer needs only keep original documents for seven (7) years for tax purposes, there is a problem documenting and re-constructing exactly what should have been assets as opposed to expenses.

We next turned to the IURC annual reports. Those reports contained amounts for fixed assets as well as CIAC. A call was placed to the former accountant, Kevin Meiring, who had taken over as LMH's accountant after his partner died in 2001. Mr. Meiring informed us that certain revenues received were recorded on the IURC annual reports, as CIAC. Assets, such as infrastructure, that were contributed were never recorded as an asset nor as CIAC on the books of the utility and were not captured on the IURC reports in a consistent manner. Therefore, we can say that both assets and CIAC on the annual reports are understated by any assets installed and then contributed to the utility. We can say that CIAC is overstated on the IURC annual reports by the amount of certain

revenues erroneously categorized as CIAC. Additionally, starting in 1995, the accountant was carrying forward the net amount of CIAC from one year to the beginning balance of gross CIAC for the next year. This continued until 2000. The consequence of all this is that a reasonably accurate cost of assets and CIAC is not possible from using the IURC annual reports.

Q19: HOW WOULD YOU ACCOUNT FOR THE DIFFERENCE BETWEEN THE ORIGINAL COST AS CALCULATED IN THE STUDY AND THE ORIGINAL COST THAT WAS ON THE BOOKS?

A: I propose to adjust the utility's books to reflect an increase in the fixed assets, additional paid in capital, retained earnings, and contributions in aid of construction (CIAC).

Q20: PLEASE EXPLAIN WHY YOU WOULD INCREASE ADDITIONAL PAID IN CAPITAL, RETAINED EARNINGS, AND CIAC.

A: The books do not reflect the true cost of the fixed assets that are providing service. Plant that had not previously been recorded as an asset either came about from:

1) not recording on the utility's books the full cost, such as not recording labor used from an affiliated company (thus the recording of this would be captured in paid in capital);

2) capital items that had been expensed in the year purchased (thus the recording of this would be captured in retained earnings), and

3) contributed assets not being recorded at all (thus the recording of this would be a debit to assets and a credit to CIAC).

Therefore, in this situation, if assets increase, one would need to increase the equity (paid in capital or retained earnings) or CIAC. Which one, depends on the nature of the original transaction.

Contributions in Aid of Construction ("CIAC")

Q21: HAD LMH RECORDED ANY CIAC ON ITS BOOKS?

A: No.

Q22: WHAT METHODS DID YOU EXPLORE TO DETERMINE AN AMOUNT FOR CIAC?

A: I first looked at the amount of CIAC in other for-profit sewer utilities. In many utilities, portions of the collection system are contributed by developers. For-profit utilities generally determine for themselves how aggressive they want to be in the collection of contributions – in both cash and infrastructure. The chart below depicts the wide range of contributed plant to total plant for several sewer utilities:

Name of Utility	IncorpType	Service	Source of Information & Year	UPIS	CIAC	% CIAC to UPIS
Kingsbury Utility Corp	For-Profit	Sewer	43296-U 2007	897,131	0	0.00%
South Haven	For-Profit	Sewer	43310 2007	11,015,823	211,777	1.92%
Twin Lakes (Utilities, Inc.)	For-Profit	Sewer	43128 2007	12,031,800	3,734,590	31.04%
Utility Center	For-Profit	Sewer	43331 2007	55,013,299	12,128,573	22.05%
Hamilton Southeastern	For-Profit	Sewer	Annual Rpt 2006	49,509,143	51,817,378	104.66%

Q23: HOW DID YOU DETERMINE AN AMOUNT FOR CIAC FOR THIS UTILITY?

A: According to Mr. Tucker, much of the collection system has been contributed by developers or customers. Mr. Tucker identified for me those items of the collection system that contributions specifically did not pay for. This resulted in contributed property of $4,175,445, which is approximately 90% of the collection system and 55% of the entire utility plant in service amount of $7,580,869.

Q24: HOW DID YOU DETERMINE THE AMOUNT OF ACCUMULATED AMORTIZATION OF CIAC?

A: I relied on the depreciation calculated on Mr. Limcaco's analysis (Exhibit CAL-2) and the representation from Mr. Tucker who identified the collection system that was and was not contributed.

Q26: IS IT APPROPRIATE TO RECOGNIZE ACCUMULATED AMORTIZATION OF CIAC?

A: Yes. LMH has re-constructed its utility plant in service figures and its contributions in aid of construction as requested by the Commission due to prior asset records being unreliable. Recognizing the accumulated amortization of CIAC is as appropriate as recognizing accumulated depreciation. Further as shown below, this benefits the ratepayers.

Q27: THE COMMISSION WAS CONCERNED WITH "RETROACTIVE RATEMAKING" IN CAUSE NO. 43128 (TWIN LAKES). IS THE PROPOSED CHANGE TO THE RATE BASE, RETROACTIVE RATE MAKING?

A: No The general prohibition against retroactive ratemaking I believe is designed to protect the public from paying for a utility's past deficits through future rates; to prevent utilities from using future rates to protect the investments of their stockholders; or to require utilities to bear losses and enjoy gains depending on their managerial efficiency.

Q28: HOW DOES NOT ACCOUNTING FOR AMORTIZATION OF CIAC EFFECT THE FINANCIAL STATEMENTS?

A: If the utility does not amortize CIAC its retained earnings in the balance sheet are under-stated because it is not off-setting its depreciation expense. This could skew the debt to equity ratios if the contributions were high enough. If one does not amortize CIAC the true value of the business is not reflected. I say that because by depreciating all assets, then not offsetting through amortizing CIAC, you are essentially saying that the value of the contribution (either cash or contributed infrastructure) has not decreased in value over time even though the asset contributed has obviously decreased in value.

Q28: WOULD IGNORING ACCUMULATED AMORTIZATION OF CIAC WHEN DETERMINING RATES LEAD TO A NEGATIVE RATE BASE?

A: Yes. The determination of rate base is essentially made by deducting both accumulated depreciation and contributions in aid of construction (not considering accumulated amortization of CIAC) from utility plant assets. If a high percentage of your plant has been contributed, and is not decreasing in conjunction with depreciation at the same rate as the asset contributed, then it is quite likely that eventually a negative situation will occur.

Q30: WHAT IS THE EFFECT OF INCLUDING ACCUMULATED AMORTIZATION OF CIAC IN RATE BASE AND THE EFFECT OF INCLUDING AMORTIZATION OF CIAC AS ON OFF-SET TO DEPRECIATION EXPENSE IN THIS PARTICULAR INSTANCE?

A: I have calculated the effect below:

Accum Amortization of CIAC		$ 833,107	
Times: Weighted Cost of Capital		9.75%	
NOI Required from Amortizing CIAC		$81,228	
Amortization of CIAC (income statement)		(104,386)	
		($23,158)	
Times Gross Revenue Conversion Factor		1.6839	
Revenue Decrease by recognizing the Amortization of CIAC in both the rate base and the expenses		($38,996)	

As can be seen, while the rate base increases, the off-set to depreciation expense is greater. Thus, ultimately the ratepayer reaps a benefit. At the same time, the company's net operating

income increases.

Capital Structure and Rate of Return

Q31: PLEASE EXPLAIN THE CAPITAL STRUCTURE AS PRESENTED IN SCHEDULE 5.

A: Common equity for purposes of this rate case has been adjusted for the proposed changes to correct rate base[1]. Just as other elements of Petitioner's rate base have been corrected for purposes of this rate case, Petitioner's capital structure has also been corrected to accurately reflect Petitioner's current capital structure. As reflected on that schedule, Petitioner's current capital structure reflects a 20.63% debt to equity ratio.

Q32: PLEASE EXPLAIN WHAT INVESTIGATIONS YOU COMPLETED AND CONCLUSIONS YOU REACHED FOR PURPOSES OF PREPARING THIS RESTATED CAPITAL STRUCTURE.

A: I verified long-term debt outstanding using the detailed general ledger. After a determination was made of the amounts for utility plant in service, accumulated depreciation, contributed plant, and accumulated amortization of contributed plant, the off-setting entries were made in determining the common equity. The proposed adjustments to the books of the utility can be seen on Schedule 2 (balance sheet). Those results are then incorporated in Schedule 5 (capital structure).

[1] See Schedule 2 – Balance Sheet

Q33: HOW DID YOU ARRIVE AT THE COST OF EQUITY SHOWN IN THIS RESTATED CAPITAL STRUCTURE?

A: The utility did not go to the expense of hiring a cost of capital witness. It was felt that the cost of such a witness would not be warranted given the customer base of approximately 1,130 and the effect it would have on rates. Therefore, I based the cost of equity on recently approved IURC causes for water and sewer companies. There are additional risks with LMH being smaller and/or not having the benefit of a large parent company with available capital to fund projects.

Q34: ON WHAT COMPANIES DID YOU MODEL THE COST OF EQUITY?

A: I noted that, of recently approved rates by the Commission, the range of cost of equity found reasonable was between 10% (Indiana-American) to 11% (Chimneywood & Wymberly). Therefore, 10.25% used here is in line with other investor-owned sewer utilities. Further I checked the resulting rates in several cases[2].

Q35: WHAT IS THE RESULTING WEIGHTED COST OF CAPITAL?

A: The calculation for the weighted cost of capital is shown on Schedule 5 and carried to Schedule 1, the result of which is 9.75%.

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[2] (Based on 5,000 gallons per month) South Haven, currently $64.95, requesting $70.71; settlement pending $66.89 in pending Cause 43310; Chimneywood $80.00; Wymberly $80.00; Sani-tech $70.00; Indiana-American Somerset $55.77, LMH proposed in this Cause $67.67.

Q36: BY MAKING THE ADJUSTMENTS TO THE COMMON EQUITY AS YOU HAVE FOR PRESENTATION IN THE RATE CASE, ARE YOU PROPOSING A HYPOTHETICAL CAPITAL STRUCTURE?

A: No, I do not believe so. The adjustments made are to accurately show the common equity which is made up of common stock, paid-in capital, and retained earnings. These corrections are the result of correcting the asset and contributions amounts recorded by the utility in its books as required by the IURC's order in Cause 43022. One cannot correct only one side of the balance sheet and still expect it to balance.

Operating Income at Current Rates

Q37: PLEASE EXPLAIN YOUR ADJUSTMENTS TO THE TEST YEAR REVENUES.

A: LMH used a cash basis of recording revenue during the test year. This means the revenue was not recorded when billed, but rather was recorded when received. To better reflect the matching of revenue to expenses, I have adjusted the test year revenues to reflect billed revenue as opposed to collected revenue (Schedule 7, adjustment 1). I have also increased the billed revenues to take into account the increase in number of residential customers during the test year. These customers have started service at various points during the test year and a full year's worth of revenue is not

reflected in the billings. Therefore, an adjustment was made to reflect the anticipated future revenues from those customers. (Schedule 7, adjustment 2).

Expenses

Q38: PLEASE EXPLAIN THE ADJUSTMENT TO PAYROLL EXPENSE.

A: During most of the test year (10/1/06 – 9/30/07), LMH had two (2) direct employees – Mr. Jay Tucker who is the CEO and general manager, and Ms. Book who is the bookkeeper. In September 2007 it was decided, due to the final order in Cause No. 43022, that two employees from UCC (an affiliated company) should become full-time employees of LMH. Both previously handled the same functions for LMH through their employment at UCC. Additionally, the salary of the Office Manager has been included. All of these adjustments properly recognize that these individuals are employees of LMH. Further, these adjustments will help eliminate any confusion or concerns created by the use of affiliated companies to perform the function of certified operators.

Q40: PLEASE EXPLAIN THE EMPLOYEE BENEFITS ADJUSTMENTS.

A: Employees of LMH receive health & life insurance coverage from Humana, Inc. through Tucker Homes, Inc. By receiving coverage with a larger pool of employees, costs are kept lower than they

otherwise would be if the three covered employees of LMH were left to get insurance as their own group. An adjustment to the test year amount paid was necessary due to: 1) adding direct employees to LMH, 2) allocating the Mr. Tucker's portion between LMH and the affiliated companies, and 3) changing insurance providers which lowered the per-employee rate. (Schedule 8, Adjustment 3)

Q41: PLEASE TELL US ABOUT EXPENSE ADJUSTMENT NUMBER FOUR (4).

A: With the full-time employment of the two operators, the contractual services and transactions with affiliated companies are almost eliminated. The test year expenses have been reduced to reflect this shift from contracted service providers to in-house personnel. (Schedule 8, adjustment 4).

Q42: PLEASE EXPLAIN YOUR EXPENSE ADJUSTMENT NUMBER FIVE (5) "NON-RECURRING EXPENSES".

A: Several invoices expensed during the test year were for items that one would not expect to occur every year. Many of the invoices eliminated from test year expenses had to do with LMH's bookkeeping issues and the prior rate case, and others were from the CTA expansion case,. Because such expenses are anticipated to not occur every year or should not be included in annually anticipated expenses, the amounts have been deducted to arrive at

pro forma expenses. (Schedule 8, adjustment 5)

Q43: HOW DID YOU DETERMINE THE AMOUNT OF RATE CASE EXPENSES TO BE AMORTIZED IN ADJUSTMENT SIX (6)?

A: I estimated legal, engineering, accounting fees, and expenses. All these costs were amortized over 3 years, the expected life of the proposed rates. There was no test year amortization of the prior rate case expenses included in test year expenses and no allowance has been made in this rate case to recover those expenses. Thus the annualized amount for rate case expense is $33,642 as shown in adjustment 6 on schedule 8.

Q44: PLEASE EXPLAIN THE ADJUSTMENT FOR PURCHASED POWER EXPENSE.

A: My examination of purchased power invoices revealed that several meters had only 11 billings included in the test year. However, one meter had 13 billings. The net affect was an increase in purchased power expense of $120. (Schedule 8, adjustment 7).

Q45: PLEASE EXPLAIN YOUR ADJUSTMENT TO TEST YEAR PROPERTY TAX EXPENSE.

A: The adjustment to property taxes increases the test year expense by $84,416. This reflects the plant in service (including contributed plant) on which property taxes will be due.

Q46: YOUR CALCULATION OF DEPRECIATION EXPENSE APPEARS TO BE BASED ON THE ESTIMATED ORIGINAL COST AS PRESENTED BY MR. LIMCACO. PLEASE EXPLAIN

THE COMPONENTS OF THE CALCULATION OF DEPRECIATION EXPENSE.

A: The depreciable utility plant in service includes Mr. Limcaco's calculation of the original cost of the utility infrastructure plus the office equipment and machinery & equipment accounts which were not included in Mr. Limcaco's study. It also eliminates the land value as determined from Mr. Limcaco's study. The resulting depreciable plant is $7,520,869 which is then multiplied by the composite depreciation rate of 2.5%. This rate was determined by the Commission to be used by utilities where no other depreciation rate has been specifically determined. I believe this is an appropriate and reasonable depreciation rate to be applied to Petitioner's plant for these rates.

Q47: PLEASE EXPLAIN WHY YOU HAVE INCLUDED AMORTIZATION OF CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC) AS AN OFFSET TO DEPRECIATION EXPENSE.

A: Depreciation expense was calculated on the full amount of assets without deduction for the assets that were contributed by developers or customers. Therefore, amortizing contributed assets is a way to offset the capital recovered through depreciation. The book, Accounting for Public Utilities[3], §6.03 states:

> In simple terms, book depreciation is merely the recognition in financial statements that physical assets are consumed in the process of providing a service or product. It should be

[3] Hahne and Aliff, etal, *Accounting for Public Utilities*, Matthew Bender Co., Inc., §6.03, page 6-5.

> remembered that book depreciation is provided for the purpose of recovering the original investment in the assets concerned, and not for providing for their replacement. Thus, book depreciation is often referred to as capital recovery.

From a *cost accounting* view, depreciation represents the costs associated with using fixed assets in the production of a product or service. Thus, if an investor takes into account that certain assets were donated or contributed to him and prices his product accordingly, he would have a cost advantage in an unregulated market, thereby under-cutting the price of competitors. "The broad objective of utility regulation is to enable the public to receive the economic benefits that would be achieved by competition from a system allowed, for operational efficiency, to operate as a monopoly." Hahne, Aliff, etal, *Accounting for Public Utilities*, Matthew Bender, §1.03 pg 13. Amortization of CIAC is necessary to achieve this objective.

Q48: HOW DID YOU CALCULATE THE AMORTIZATION OF CIAC?

A: I calculated the amount of amortization by multiplying the amount of contributed assets by the rate of depreciation used for that property (2.5% composite rate).

Q49: WHY IS THIS USE OF THE DEPRECIATION RATE THE APPROPRIATE RATE FOR AMORTIZING CIAC?

A. The asset and the contributed asset is the same item. If the value

of the asset is decreasing at a certain rate, then the value of the contribution is decreasing at that same rate.

Non-Recurring Charges

Q50: PLEASE LIST THE TYPES OF NON-RECURRING CHARGES WHOSE APPROVAL IS BEING REQUESTED IN THIS CAUSE.

A: The utility is requesting approval of the following non-recurring charges:

- Insufficient check charge (NSF Fee charge)
- Customer deposit charge
- System Development Charge

Q51: PLEASE EXPLAIN WHY THERE IS A NEED FOR EACH OF THESE NON-RECURRING CHARGES.

A: The insufficient check charge is needed to offset the costs caused by customers who pay their bill with a check from a bank account which has insufficient funds to make good on the payment. Since this cost is being caused by only certain customers, it is not reasonable to make all customers absorb the cost. We have calculated the cost of a customer submitting an insufficient funds check as $7.00. This calculation is made on Schedule 9.

The customer deposit charge will be used in accordance with Indiana Administrative code (170 IAC 6-1-15). Thus, only those customers who fail to establish that they are creditworthy will be assessed this charge. It has become apparent to the utility that this

deposit is necessary due to customers leaving the system without paying their utility bill. If a deposit is held for a customer who leaves and still owes the utility for service, the amount owed for service can be taken out of the deposit and any remainder returned to the former customer. This non-recurring charge alleviates the burden of non-paying customers from the rates paid by all customers.

System Development Charge – This charge is needed as a way to help finance infrastructure improvements needed due to growth of the customer base. The fee was calculated based on the cost of new treatment plant and the capacity of that new plant. The funds generated by this fee will be accumulated and used for future infrastructure.

Q52: HAVE YOU PROVIDED THE NECESSARY CALCULATIONS THAT ESTABLISH THE AMOUNTS REQUESTED FOR THE NON-RECURRING FEES?

A: Yes, they are included as Schedule 9 in Exhibit JIG-1.

Wholesale Rate

Q53: WHY IS A WHOLESALE RATE NECESSARY FOR LMH UTILITIES?

A: The Dearborn County Regional Sewer District ("DCRSD") has requested service for the Serenity Ridge subdivision which is just outside LMH's certified territory authority (CTA). DCRSD does not

have a sewage treatment facility to provide service to this area. However, DCRSD will own the collection system within Serenity Ridge. It is at DCRSD's urging that we provide them with a wholesale rate.

Q54: WHAT IS LMH PROPOSING FOR A WHOLESALE RATE?

A: The calculation is on Schedule 9, page 2. The result is a volumetric charge of $10.10 with no monthly base charge.

Q55. HOW DID YOU DETERMINE THAT RATE?

A. I included only treatment plant and expenses related to treatment and administration. Specifically, I first calculated a return on the treatment plant rate base as of the test year end (no collection system was included). I then determined the *pro-forma* expense items related to the treatment system and administrative and general expenses related to wholesale service. I then divided those expenses by the annual *pro forma* volume. This produced a volumetric rate of $10.10 per 1,000 gallons.

Q56: WHEN WILL THE WHOLESALE RATE BE CHARGED?

A: The rate will be charged when DCRSD is prepared to physically connect to LMH. A specific date for service to begin is not known. However, DCRSD is in need of knowing the cost for wholesale service so it may proceed in setting its own rates and obtaining

funding to construct its collection system.

Q57. WILL DCRSD ALSO BE SUBJECT TO THE SYSTEM DEVELOPMENT CHARGE IF APPROVED?

A. Yes. As each residence connects to DCRSD's collection system, DCRSD will collect the fee and remit it to LMH.

Q58: DOES THIS CONCLUDE YOUR TESTIMONY.

A: Yes, at this time.

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L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Revenue Requirement

Description:		Sch Ref
Estimated Original Cost Rate Base	$2,546,660	4
Times: Weighted Cost of Capital	9.75%	5
Net Operating Income Required	248,299	
Less: Adjusted Net Operating Income	(23,955)	6
Net Revenue Required	272,254	
Times: Gross Revenue Conversion Factor	1.6839	1
Recommended Revenue Increase	$458,444	
Percentage Increase - Calculated	75.53%	
Percentage Increase Requested	75.53%	

Rate Impact	Current*	After Increase
Per 5,000 gallons of usage	38.55	$67.67

* Current Rates established pursuant to IURC Cause No. 40891 dated January 21, 1998.

Gross Revenue Conversion Factor

	Description		Proposed Rates
1	Gross Revenue Change	100.0000%	$458,444
2	Bad Debts Charge	0.0000%	0
3	Subtotal	100.0000%	
4	IURC Fee (2007-2008 Fiscal Year)	0.1315587%	603
5	Subtotal	99.8684%	
6	State Utility Receipts Tax (1.4% of line 3)	1.4000%	6,418
7	Subtotal	98.4684%	
8	State Adjusted Gross Receipts Tax (8.5%of line 5)	8.4888%	38,916
9	Subtotal	89.9796%	
10	Federal Income Tax (at 34%)	30.5931%	140,252
11	Change In Operating Income	59.3866%	$272,254
12	Gross Revenue Conversion Factor	1.6839	

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Balance Sheet as of 09/30/07

	Per books 2007	Proposed Adjustments		Adjusted 2007
Assets and Other Debits:				
Fixed Assets:				
Utility Plant In Service	2,473,475			7,372,669
RODEO'S MAIN EXTENSION	22,289			
MT MEADOWS MAIN EXT - 2007	2,713			
Hidden Acres Extension	250			
Subtotal	2,498,726	4,873,943	a	7,372,669
OFFICE EQUIPMENT	9,555			9,555
MACH & EQUIP	179,381			179,381
Transportation Equipment	19,264			19,264
Utility Plant in Service total	2,706,926			7,580,869
Less: Accumulated Depreciation	1,009,952	823,845	b	1,833,797
Net Utility Plant In Service	1,696,974			5,747,073
Construction Work In Progress				
Total Utility Plant	1,696,974			5,747,073
Abandoned Plant				
Total Plant	1,696,974			5,747,073
Other Assets and Investments				
Current and Accrued Assets:				
Cash - checking	818			818
Cash - Escrow	14,025			14,025
Accounts Receivable	1,283			1,283
Accounts Receivable - Other				
Total Current and Accrued Assets	16,125			16,125
Deferred Debits:				
Deferred Rate Case Expense (net of Amort)	104,347			104,347
Deferred Loan Origination Costs	6,189			6,189
Total Assets and Other Debits	$1,823,635			$5,873,734

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Balance Sheet as of 09/30/07

Liabilities and Stockholders Equity:	9/30/2007	Proposed Adjustments	2007
Stockholders Equity:			
Common Stock	$ 1,000		$ 1,000
Other Paid-in Capital	759,811	4,873,943 a	1,659,310
		($4,175,445) c	
Common Equity - Affiliated investment		$201,000 e	
Retained Earnings	194,444	(823,845) b	206,707
		836,107 d	
Current Income (Jan - Sept 30, 2007)	(65,798)		(65,798)
Total Stockholders Equity	889,457		1,801,218
Long Term Debt			
N/P - GMAC	10,227		10,227
NOTE PAYABLE-TDC	265,000		265,000
MAINSOURCE BANK 100024709	96,449		96,449
Total Long Term Liabilities	371,676		371,676
Current and Accrued Liabilities:			
Accounts Payable	245,103		245,103
Accounts Payable -Assoc. Companies	1,200		1,200
Developer Deposits (Advances for Construction)	100,300		100,300
			-
Accrued Taxes - Payroll	3,748		3,748
Notes Payable - Shareholder/Related party	201,000	(201,000) e	-
Accrued Taxes - Indiana Sales Tax			-
Accrued Taxes - Federal Income Tax			-
Accrued Interest - Shareholder	11,151		11,151
Total Current and Accrued Liabilities	562,502		361,502
Deferred Credits:			
Unamortized ITC			
Deferred Tax - Federal			
Deferred Tax - State			
Total Deferred Credits	0		0
Contribution In Aid Of Construction - Sewer		$4,175,445 c	4,175,445
Less: Accumulated Amortization of CIAC (based on Engineering calculation of depreciation)		836,107 d	836,107
Net Contributions in Aid of Construction	0		3,339,337
Total Liabilities and Stockholders Equity	$ 1,823,635		$ 5,873,734

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Income Statement For The 12-months Ended 9/30/07

Operating Revenues:	2007
Sewer Revenues Residential	$539,986
Sewer Revenues Commercial	40,661
Sewer Revenues Multi-Family Dwellings	30,431
Hauled Waste	14,835
Tap Fees (Net of Cost)	(22,217)
Jobbing (pump sales, connections, service line work)	29,272
Total Operating Revenues	632,968
Operating Expenses:	
Salaries and Wages	84,319
Payroll Taxes	6,973
Pension & Other Benefits	
Purchased Power	64,409
Sludge Removal & Disposal	98,770
Maintenance & Repair	1,770
Materials & Supplies	48,995
Chemicals	8,287
Contract Services	238,879
Accounting	3,660
Legal	15,365
Office Supplies & Other Office Expenses	16,018
Rent	6,000
Transportation	863
Insurance	24,470
Dues & Permits & Licenses	3,560
Miscellaneous	1,098
Total Operations and Maintenance Expenses	623,436
Depreciation	
Amortization of CIAC	
Taxes other than Income:	
Utility/Commission Tax (see dues & licenses $876)	
Property Tax	9,680
Utility Receipts Tax	2,750
Amortization of Investment tax credit	
Income Taxes - Federal	0
Income Taxes - State	(500)
Total Operating Expenses	635,367
Net Income from operations	($2,399)
Other Income (Deductions:)	
Availability Fee	3,000
Subsequent Connector Fees	1,300
Interest during construction	
Interest on Debt	
Net Corporate Income	$1,901

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Calculation of Rate Base as of 09/30/07
Based on information from engineer's study and management

Description:	
Utility Plant In Service as of 09/30/07 (from study)	$7,580,869
Less: Accumulated Depreciation (from study)	1,833,797
Net Utility Plant in Service 09/30/07	5,747,073
Less: Contributions in Aid of Construction	4,175,445
Accumulated Amortization of CIAC	(836,107)
Adding UPIS held by affiliated company, but used and useful in utility service	
Add - Sludge Press, net of depr (100% of book value)	62,250
Add- Vacuum Truck, net of depr (75% of book value)	21,000
Total Net Utility Plant In Service	2,490,985
Add: Working Capital (See Below)	55,674
Total Original Cost Rate Base	$2,546,660

Working Capital Calculation

Description	
Pro-forma Present Rate Operations and Maintenance Expense	$524,387
Less: Payroll Taxes	14,463
Less: Bad Debts (Uncollectible Accounts) Expense	
Less: Purchased Power	64,529
Adjusted Operation and Maintenance Expense	445,396
Times: 45 day method	0.125
Working Capital Requirement	$55,674

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Capital Structure

Description	Amount	Percent of Total	Cost	Weighted Cost
Common Equity (adjusted)	$1,801,218	82.89%	**10.25%**	8.50%
Long Term Debt				
GMAC	10,227	0.47%	0.00%	0.00%
Note Payable TDC (Merchant's Bank holds $150,000)	265,000	12.20%	7.50%	0.91%
Mainsource Bank	96,449	4.44%	7.75%	0.34%
Total	$2,172,895	100.00%		9.75%

Synchronized Interest Calculation
(For use in Income Tax Calculation)
Sewer

Description:	As Of 9/30/2007
Total Original Cost Rate Base-See Sch. 4	$2,546,660
Times: Weighted Cost of Debt	1.25%
Synchronized Interest Expense	$31,833

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Pro-forma Net Operating Income Statement

Description:	Year Ending 9/30/2007	Adjustments	Sch. Ref.	Pro-forma Present Rates	Adjustments	Sch. Ref.	Pro-forma Proposed Rates
Operating Revenues:							
Sewer Revenues - Residential, Commercial, other	$611,078	($9,018)	7-1	$ 606,965	$458,444	1	$1,065,410
		4,905	7-2				
Hauled Waste	14,835			14,835			14,835
Tap Fees (Net of Cost)	(22,217)	22,217	7-3	0			0
Jobbing (pump sales, connections, service line work)	29,272			29,272			29,272
Total Operating Revenues	632,968	18,104		651,072	458,444		1,109,516
Operating Expenses:							
Operations and Maintenance	623,436			524,387			524,990
Salaries & Wages		100,570	8-1				
Payroll Taxes		7,490	8-2				
Employee Benefits		1,749	8-3				
Affiliated Contractual Services		(226,800)	8-5				
Non-recurring Expenses		(15,843)	8-6				
Rate Case (amortized)		33,642	8-7				
Purchased Power		120	8-8				
IURC Fee		24	8-9		603	1	
Taxes other than Income:							
Property taxes	9,680	84,416	8-10	94,096			94,096
Utility Receipts Tax	2,750	5,941	8-13	8,691	6,418	1	15,109
Depreciation	0	188,022	8-11	188,022			188,022
Amortization of CIAC	0	(104,386)	8-12	(104,386)			(104,386)
Income Taxes - Federal	0	(28,739)	8-14	(28,739)	140,252	1	111,513
Income Taxes - State	(500)	(6,545)	8-15	(7,045)	38,916	1	31,872
Total Operating Expenses	635,367	39,660		675,026	186,190		861,216
Net Operating Income	($2,399)	($21,555)		($23,955)	$272,254		$248,299

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Revenue Adjustments

(1)
Accrual Billing

To recognize revenue when earned rather than when received.

Billed Revenue:		
Residential	$535,215	
Commercial	$34,019	
Other	$32,826	
Total		$602,060
Less: Revenue recorded on cash basis		611,078
Adjustment - (Decrease)		($9,018)

(2)
Residential Customer Normalization

To adjust test year residential revenue for customer additions during the test year.

Month -	# of Customers (A)	Growth (B)	Remaining (C)	[(B) x (C)] 1 # of Bills (D)	Sales (E)	[(E) ÷ (A)] Avg Sale (F)	[(D) x (F)] Additional Sales (G)
Oct-06	1,062		0		$43,907	$41.34	
Nov-06	1,065	3	1	3	45,107	42.35	
Dec-06	1,072	7	2	14	42,378	39.53	
Jan-07	1,070	(2)	3	(6)	41,936	39.19	
Feb-07	1,093	23	4	92	43,619	39.91	
Mar-07	1,093	0	5	0	43,450	39.75	
Apr-07	1,093	0	6	0	40,464	37.02	
May-07	1,090	(3)	7	(21)	38,972	35.75	
Jun-07	1,091	1	8	8	50,319	46.12	
Jul-07	1,081	(10)	9	(90)	50,125	46.37	
Aug-07	1,083	2	10	20	47,650	44.00	
Sep-07	1,092	9	11	99	47,288	43.30	
Adjustment - Increase (Decrease)				119		$41.22	$4,905

(3)
Tap Fees

To recognize that tap fees,and its expense, should be recognized as an Asset and Contribution in Aid of Construction (C

Adjustment - Increase (Decrease)	$22,217

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Expense Adjustments

(1)
Wages

#	Employee	Title	Regular Rate of Pay*	Regular Avg Hours/yr	Overtime Rate of Pay	Overtime Hours/Year	Overtime Pay	Annualized
	Individual salaries are confidential							
		Pro forma Wage Expense						184,889
		Less Test Year						84,319
* Includes 2% increase for 2008					Adjustment - Increase			$100,570

(2)
Payroll Tax

FICA			
Pro Forma Salaries & Wages	$184,889		
Times Rate	7.65%		
Pro forma FICA Tax		$14,144	
State & Federal Unemployment Tax			
assessed on first $7,000 of wages paid to each worker	35,000		
Times Rate	0.91%		
Pro Forma SUTA & FUTA Tax		319	
Pro Forma Payroll Taxes			$14,463
Less Test Year			6,973
		Adjustment - Increase	$7,490

(3)
Employee Benefits

To recognize a decrease in premiums due to elimination of vision coverage and an increase in the number of employees covered by insurance

	Health Insurance	Life	Annuity	Total	Less Employee Share	Net Expense
Individual benefits are confidential						
Pro Forma Benefits						14,429
Less Test Year						12,680
			Adjustment - Increase			$1,749

L.M.H. UTILITIES CORP.
CAUSE NO. 43431

Expense Adjustments

(4)

Affiliated Contractual Services

To eliminate contract services formerly performed by an affiliate (UCC), which on an on-going basis will be performed in-house by LMH employees.

7730.1	Contract Services - Operation		$103,073
7711 & 7711.2	Sludge Removal		$74,200
7735.1	Contractural Services - Laboratory Expense	11 months @ $1,600/month	17,600
7730.3	Contractual Services - maintenance	11 months @ $2,902.50/month	31,928
	Adjustment - (Decrease)		($226,800)

(5)

Non-Recurring Expenses

To adjust test year for expenses incurred in the test year, but unlikely to occur on a re-curring basis or that are capital items expensed in test year

Acct #	Vendor & Description	Date	Amount
7731.8	Algeawheel - Engineering Services (valuation study)	8/15/07	$3,800
7733.8	Dann Pecar & Newman - Expansion of Territory	1/18/07	1,110
7733.8	Dann Pecar & Newman - Expansion of Territory	2/20/07	575
7733.8	London-Witte Group - rate case and bookkeeping issues	5/31/07	2,296
7733.8	London-Witte Group - rate case and asset issues	6/30/07	805
7733.8	London-Witte Group - asset issues	7/31/07	726
7732.8	London-Witte Group - asset issues	8/31/2007	3,575
7733.8	Bose McKinney & Evans - asset/rate base issues	9/21/2007	2,470
7733.8	Bose McKinney & Evans - asset/rate base issues	8/15/2007	488
	Adjustment - (Decrease)		($15,843)

(6)

Rate Case Amortization

To adjust for unamortized rate case expense based on estimates and "not to exceed" limits.

		Total
Legal Fees	40,000	
Engineer Fees	20,000	
Accounting Fees	40,000	$100,000
Customer Notice:		
Postage (1,100 notices x 41¢)	451	
Paper Stock (1,100 notices x .0526¢)	58	509
Travel		
Travel (2 trips x 182 miles round trip * $.485 Federal reimbursement rate)	177	
Hotel/Accommodations (1 room @$120 per night x 2 nights)	240	417
Cost of Capital Witness		**0**
Costs of Mailing and Copies		
Cost of current rate case expense		100,925
Amortized over 3 years		3
pro forma proposed rate case expense		33,642
Less: Test Year		0
Adjustment - Decrease		$ 33,642

L.M.H. UTILITIES CORP.
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Expense Adjustments

(7)
Purchased Power

To adjust operating expense for a full 12 months of purchased power.

Pro forma - 12 months purchased power expense	$64,529
Less: Test Year	64,409
Adjustment - Increase (decrease)	$120

(8)
IURC Fee

To normalize Utility Regulatory Commission Fees.

Additional Revenues	$18,104
Rate	0.1315587%
Adjustment - Increase (decrease)	$23.82

(9)
Property Tax

To increase property tax expense to reflect additional plant in service

Utility Plant in Service, net of depreciation		$5,747,073
Times: Rate		1.91
Tax Amount		109,792
Less: Tax Credit		
Tax Amt	$109,792	
Times Credit	14.30%	
Amount of Credit		15,696
Pro forma Property Tax Expense		94,096
Less: Test Year		9,680
Adjustment - Increase (decrease)		$84,416

(10)
Depreciation Expense

To update depreciation expense, reflecting additional plant and authorized depreciation rates.

Utility Plant in Service per books - 09/30/07	$2,706,926
Add: Additional estimated original cost per study	4,873,943
Less: Land	60,000
Total Depreciable Plant in Service	7,520,869
Depreciation Rate (Composite Rate)	2.50%
Pro-Forma Plant Depreciation expense	188,022
Less: Test Year	0
Adjustment -Increase	$188,022

(11)
Amortization of CIAC

To amortize Contributions in Aid of Construction.

	Sewer
CIAC per books 09/30/07	$0
Add: CIAC estimated on original cost	$4,175,445
Total CIAC subject to amortization	$4,175,445
Times depreciation rate of assets	2.50%
Amortization of CIAC	$104,386
Less: Test Year	$0
Adjustment - Decrease Expense	($104,386)

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Expense Adjustments

(12)
Utility Receipts Tax

To adjust taxes to current conditions.

SEWER	Pro Forma Gross Receipts	Less Jobbing sales	Less Bad Debts	Less $1000 exemption	Taxable Amount	Times Rate	Adjustment
Utility Receipts Tax	$651,072	29,272	0	$1,000	$620,800	1.40%	$8,691
Less: Test Year							2,750
Adjustment - Increase							$5,941

(13)
Federal Income Taxes

To adjust Federal Income Taxes to Pro-forma Present Rate amount.

	Pro-Forma Present Rates
Total Revenue	$651,072
Less:	
Operation & Maintenance Expenses	524,387
Bad Debts Expense	0
Synchronized Interest	31,833
Depreciation & Amortization	83,636
Taxes other than Income (other than URT)	94,096
Net income before income taxes	(82,881)
Indiana Utility Receipts Tax	8,691
Indiana Adjusted Gross Income Tax	(7,045)
Federal Taxable Income	(84,527)
Federal Tax Rate	34.00%
Sub-total Pro Forma Present Rates Federal Income Taxes	(28,739)
Less: Test Year	0
Adjustment - Increase (decrease)	$ (28,739)

(14)
State Income Tax

To adjust State Income Taxes to Pro-forma Present Rate amount.

	Pro-Forma Present Rates
Federal Taxable Income	(84,527)
Add: Taxes Based on Income:	
Utility Receipts Tax	8,691
State Adjusted Gross Income Tax	(7,045)
State Taxable Income	(82,881)
Rate	8.50%
Indiana Adjusted Gross Income Tax	(7,045)
Less: Test Year	(500)
Adjustment - Increase (decrease)	$ (6,545)

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Non-Recurring Charges

NSF fee			
Charge from Bank	$0.00		
Process by bookkeeper	4.12		
phone call & letter (10 minutes & postage)	2.96		
Calculated Cost	$7.08		
Requested NSF Fee			$7.00
Customer Deposit			
Average residential usage	5,700	gallons per month	
Average monthly rate (with proposed increase)	$73.97		
Times 2 months	2		
Customer Deposit - residential			$147.94
System Development Charge			
Using Incremental Marginal Cost Method			
Cost of new plant (180,000 gallons per day)			$1,362,827
Capacity of new plant	180000	gallons per day	
IDEM Average Daily EDU usage - design capacity	310	gallons per day	
Capacity of plant in EDU's	581		
Cost of plant			$1,362,827
Number of EDU's capacity			581
Cost of plant per EDU			$2,347.09
50% paid by applicant for service (developer or customer)			$1,173.55

**Fee will be paid upon sewer permit application*

Wholesale rate calculation

1. Return on Assets other than Collection System

Assets other than Collection System (net of depreciation)	$2,034,198
Times Weighted Cost of Capital	9.75%
Net Operating Income Required	$198,334

Plus Pro Forma Operating Expenses:	Total	Only treatment & Admin related	Trmt & Admin Related to Wholesale Rate
Salaries and Wages	184,889	$167,476	$167,476
Payroll Taxes	14,463	13,130	13,130
Pension & Other Benefits	14,429	12,131	12,131
Purchased Power	64,529	47,756	47,756
Sludge Removal & Disposal	24,570	24,570	24,570
Maintenance & Repair	1,770	1,770	1,770
Materials & Supplies	48,995	5,389	5,389
Chemicals	8,287	8,287	8,287
Contract Services	82,479	74,674	74,674
Accounting	85	85	85
Legal	6,896	6,896	6,896
Amortization of Rate Case Expense	33,642	33,642	33,642
Office Supplies & Other Office Expenses	16,018	16,018	4,105
Rent	6,000	6,000	6,000
Transportation	863	863	863
Insurance	11,790	9,432	9,432
Dues & Permits & Licenses	3,560	3,560	3,560
IURC Fee	627	627	627
Miscellaneous	1,098	1,098	1,098
Operating Expenses	524,990	433,405	421,493
Property Tax	94,096	33,306	33,306
Utility Receipts tax	15,109	15,109	15,109
Depreciation	188,022	50,855	50,855
Amortization of CIAC	(104,386)		
Operating Expenses before Income Tax	717,832	532,676	520,763
Federal Income Tax	111,513	111,513	111,513
State Income Tax	31,872	31,872	31,872
Total Operating Expenses	861,216	676,060	664,147

Annual Volume (1,000 gallons)	85358.772	
Expenses per 1,000 gallons - totally volumetric		$7.78
Return per 1,000 gallons - totally volumetric		$2.32
Rate Per 1,000 gallons if totally volumetric rate is applied		$10.10
Times average usage (5,700 gallons/month)		5.7
Average Bill - Wholesale Rate		$57.59

L.M.H. UTILITIES CORP.
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Current and Proposed Rates

(I) Metered Users:

(A) Each user shall pay a monthly base charge in accordance with the following applicable size of meter installed.

Meter Size		Current Monthly Base Charge	Proposed Monthly Base Charge
5/8 - 3/4	inch meter	$12.90	$22.64
1	inch meter	26.45	$46.43
1 1/4	inch meter	39.99	$70.19
1 1/2	inch meter	56.24	$98.72
2	inch meter	94.17	$165.30
3	inch meter	211.56	$371.35
4	inch meter	365.07	$640.81
6	inch meter	825.60	$1,449.18

(B) In addition to the monthly base charge set forth above, each user shall pay a monthly usage charge based upon their monthy water consumption.

	Current Monthly Flow Charge	Proposed Monthly Flow Charge
Flow Charge (Per 1,000 gallons)	$5.13	$9.00

This section not needed

~~(II) Residential Unmetered users (per month)~~

~~month rate based upon an average monthly consumption of 6,700 gallons.~~

~~Residential Single Family on official tariff 42.28~~

Wholesale Rate:
Applicable when another sewer utility requests wholesale service for their customers' waste.
Flow Charge (Per 1,000 Gallons) $10.10
(Note: No Base Charge is applicable to wholesale rate customers)

Non-Recurring Charges

	Current Rates	Proposed
Tap-On Fee	$625.00	$625.00
NSF check charge	$0.00	$7.00

Late Fee

If the net bill is not paid within seventeen (17) days after the bill is mailed, it shall become a delinquent bill and a late payment charge will be added in the amount of ten percent (10%) of the first three (3) dollars and three (3) percent of the excess of three (3) dollars.

Reconnection charge:
Actual cost of disconnection and reconnection, the estimated cost of whch will be furnished to customer with cut-off

Hauled Waste (rate per 1,000 gallons)	$45.00	$45.00

Customer Deposit (2 months avg bill)
Residential Customers $147.94

Subject to Indiana Administrative Code 170 IAC 6-1-15

Sprinkler Credit

For customers who have a meter attached to their sprinkler systems (outdoor spicket), credit will be given for the water usage as verified through the sprinkler meter.

System Development Charge

A system development charge will be assessed to all applicants for sewer service. The fee will be charged at the time of sewer permit application.

5/8"	meter connection	(1 edu)	$1,174
3/4"	meter connection	(1.5 edu)	1,760
1"	meter connection	(2.5 edu)	2,934
1 1/2"	meter connection	(5 edu)	5,868
2"	meter connection	(8 edu)	9,388
3"	meter connection	(17.5 edu)	20,537
4"	meter connection	(30 edu)	35,206
6"	meter connection	(62.5 edu)	73,347

* Current Rates established pursuant to IURC Cause No. 40891 dated January 21, 1998.